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UNCLAS SECTION 01 OF 07 COLOMBO 001121

SIPDIS

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E.O 12958: N/A
TAGS: ETRD ECON EFIN CE
SUBJECT: SRI LANKA: 2010 NATIONAL TRADE ESTIMATE REPORT (Resubmit)

REF: SECSTATE 105978
COLOMBO 1011

¶1. The following is in response to Ref A's request for information on the National Trade Estimate in Sri Lanka. Ref B includes information for the Sanitary and Phytosanitary (SPS) and Standards Related Foreign Barriers to trade in Sri Lanka, submitted November 4, 2009 (and also included here).

TRADE SUMMARY

¶2. The U.S. goods trade deficit with Sri Lanka was $1.7 billion in 2008, a decrease of $160 million from $1.8 billion in 2007. U.S. goods exports in 2008 were $283 million, up 24.7 percent from the previous year. Corresponding U.S. imports from Sri Lanka were $2 billion, down 5.0 percent. Sri Lanka is currently the 116th largest export market for U.S. goods.

¶3. The stock of U.S. foreign direct investment (FDI) in Sri Lanka was $80 million in 2007 (latest data available), up from $69 million in 2006.

IMPORT POLICIES

¶4. Despite an economy open to foreign investment, the pace of reform in Sri Lanka has been uneven. President Rajapaksa's broad economic strategy focuses on poverty alleviation and steering investment to disadvantaged areas, large scale infrastructure projects, developing the small- and medium-sized enterprise sector, promotion of agriculture, and expanding the already large civil service.

¶5. The Trade, Tariff, and Investment Policy Division of the Ministry of Finance and Planning is charged with the formulation and implementation of policies in these areas. In addition, the Trade and Tariff cluster of the National Council of Economic Development (NCED) also examines trade and tariff issues and sends recommendations to the Ministry of Finance and Planning. In July 2009, the President appointed a Presidential Taxation Committee to examine the entire tax system including import tariffs.

IMPORT CHARGES

¶6. Sri Lanka's main trade policy instrument has been the import tariff. According to the WTO, in 2006, Sri Lanka's average applied

tariff for nonagricultural goods was 9.2 percent. Its average bound tariff for these goods was 19.6 percent. However, approximately 70 percent of Sri Lanka's nonagricultural tariffs are unbound under WTO rules and can be increased at any time. Sri Lanka's average applied agricultural tariff in 2006 was 23.8 percent.

¶7. Currently in Sri Lanka, there are five tariff bands: 0 percent; 2.5 percent; 6 percent; 15 percent; and 28 percent. Textiles, pharmaceuticals, and medical equipment are duty free. Basic raw materials are generally assessed a 2.5 percent duty. Semi-processed raw material tariffs are 6 percent, while intermediate product tariffs are 15 percent. Most finished product tariffs are 28 percent. There are also a number of deviations from the five band tariff policy. Some items are subject to an ad valorem or a specific duty, whichever is higher, and there is intermittent use of exemptions and waivers. Footwear, ceramic products, and agricultural products carry specific duties.

¶8. In addition to tariffs, a variety of taxes introduced (see below) in the past several years have effectively increased Sri Lanka's tax rates on a range of imported items to between 60 and 100 percent of the cost, insurance, and freight (CIF) value of the product. The government has imposed these charges on imports primarily to raise revenue, to defray the costs of specific government services, or to promote local producers. Most of these charges are revised upwards annually. In addition, the government imposed a new Nation Building Tax of 1 percent on imports on February 1, 2009; it was increased to 3 percent on May 1, 2009. The frequent changes (mostly upward) of these rates have added unpredictability to foreign exporters' and local importers' cost calculations. Affected products from the United States include fruits, processed/packaged food, and personal

care products.

¶9. Other charges on imports include:

9A. An Export Development Board (EDB) levy, ranging from 10 percent to 35 percent ad valorem on a range of imports identified as "nonessential." Most of the items are subject to specific duties as well; for example, shampoo (35 percent or Rs 175 per kg), apparel (30 percent or Rs 75 per unit), biscuits (35 percent or Rs 60 per kg) and oranges (20 percent or Rs 15 per kg). Whichever levy is higher - percentage versus a flat rate - is applied. Also, when calculating the EDB levy, an imputed profit margin of 10 percent is added onto the import price. In some cases, such as on biscuits, chocolates and soap, the tax is charged not on the import price but on 65 percent of the maximum retail price. The EDB levy on most imports was increased by raising the specific duties (unit rate) in November 2008 and in 2009.

9B. An import duty surcharge of 15 percent on all dutiable imports (increased from 10 percent as of November 8, 2007).

9C. A Ports and Airports Development Levy of 5 percent on imports (increased from 2.5 percent to 3 percent in January 2007; and to 5 percent from January 1, 2009).

9D. A VAT of 0 percent, 12 percent, or 20 percent. When calculating the VAT, an imputed profit margin of 10 percent (increased from 7 percent on January 1, 2007) is added on to the import price. Locally manufactured products are also subject to VAT but not the imputed profit margin. The new VAT rate of 12 percent was introduced on January 1, 2009 replacing the VAT rates of 5 percent and 15 percent.

9E. Excise fees on some products such as aerated water, liquor, beer, motor vehicles, and cigarettes. The list of products subject to these fees was expanded in 2007 to include certain household electrical items. When calculating the excise fee, an imputed profit margin of 15 percent (increased from 10 percent on October 11, 2007 and from 7 percent on January 1, 2007) is added on to the import price. Locally manufactured products are also subject to excise fees.

9F. A Social Responsibility Levy, a surcharge of 1.5 percent

assessed on the import duty to fund the National Action Plan for Children. This tax was increased from 1 percent as of November 8, ¶2007.

9G. A new Nation Building Tax (NBT) on imports was introduced on February 1, 2009 at 1 percent. It was increased to 3 percent on May 1, 2009.

¶10. A regional infrastructure fee of 5 percent, 7.5 percent or 10 percent (based on engine capacity) is imposed on automobiles. This tax, first introduced in January 2007 at a flat rate of 2.5 percent, was increased in 2008.

¶11. Textiles and Apparel: Textiles are free of customs import duty. There is an Export Development Board Levy (often referred to as a cess) of 50 Rupees (approximately $0.45) per kilogram on imported textiles not intended for use by the apparel export industry. All textile imports are subject to a Nation Building Levy of 3%, Ports and Airports Tax of 5%, Social Responsibility Levy of 1.5% and a Value Added Tax (VAT) of 12%.

¶12. Currently, apparel imports are subject to a 15 percent import duty, a 30 percent or Rs 75 per unit Export Development Board Levy, a 12 percent Value Added Tax, a 5 percent Ports and Airports Levy, a 1.5 percent Social Responsibility Levy and a 3 percent Nation Building Tax.

¶13. In October and November 2008, the Central Bank introduced limits on forward contracts for the sale and purchase of foreign exchange, prevented prepayments on import bills, and imposed a 100 percent deposit requirement on Letters of Credit for the import of non-essential items. In the case of motor vehicle imports, the

deposit requirement was 200 percent of the import value. These restrictions were introduced to discourage imports due to a foreign exchange shortage and were later lifted.

¶14. The U.S. Government engaged in bilateral Trade and Investment Framework Agreement (TIFA) talks with the government of Sri Lanka in October 2009. In response to U.S. concerns that combined tariffs, levies, and taxes greatly exceed Sri Lanka's bound rates for many imports, the GSL explained that it had established a Presidential Tariff Commission to simplify its tax and tariff structure and to bring it into compliance with international agreements. The United States stressed the importance of reducing Sri Lanka's high tariffs on agricultural products; opening the Sri Lankan market for U.S. agricultural biotechnology products; providing more certainty and transparency in Sri Lanka's government procurement, and integrating U.S. technical assistance into the government of Sri Lanka's overall intellectual property rights enforcement plan. The Embassy continues to follow up and press the Sri Lankan government to take action.

IMPORT LICENSING

¶15. Sri Lanka requires import licenses for over 400 items at the 6-digit level of the Harmonized Tariff System code, mostly for health, environment, and national security reasons. Importers must pay a fee equal to 0.1 percent of the import price to receive an import license.

CUSTOMS ADMINISTRATION

¶16. The government of Sri Lanka implemented the WTO Customs Valuation Agreement in January 2003 and follows the transaction value method to determine the CIF value. The scheme has operated quite successfully and major companies have not faced problems. Customs is also in the process of installing an Electronic Data Interchange system to support an automated cargo clearing facility. When implemented, this system should improve customs administration and facilitate trade.

STANDARDS

¶17. The Sri Lanka Standards Institution (SLSI) is operating a

Compulsory Import Inspection Scheme (covering 102 items) per regulations framed under the Imports and Exports Control Act, No. 1 of 1969 as amended by Act No. 28 of 1987. According to the Imports Standardization and Quality Control Regulations of 2006, conformity of the imported products to the relevant Sri Lankan Standards is monitored. Samples are drawn from consignments accompanied by a quality certificate from an accredited laboratory or manufacturer registered with SLSI, which could be subject to testing or random check, or if there is a reasonable doubt regarding the quality of the consignment.

¶18. Sri Lanka has introduced new food safety regulations. According to the Adoption of Standards Regulations of 2008 (Ref. No. 1589/34 - FEB 2009), 158 SLSI standards were made mandatory starting in September 2009 for certain food and beverage products. (NOTE: Post will provide a PDF document containing notification of the regulations per request. END NOTE.) The SLSI standards range from commodities to processed products. Though these standards did exist previously, they were for the most part voluntary. Some U.S. companies are concerned that these newly-mandatory measures do not factor in market preferences and could restrict trade. The Ministry of Health, which is the CODEX focal point, plans to notify the WTO with regard to this new regulation.

TECHNICAL BARRIERS TO TRADE

¶19. In January 2007, the Ministry of Health adopted a regulation for the import, sale and mandatory labeling of genetically engineered (GE) food products, potentially costing U.S. industry as much as $20 million. This regulation is moving towards full implementation, although some aspects of it are irregularly enforced or not enforced at all. Key problems with the regulation include: mandatory Sri Lankan regulatory approval of foods with 0.05 percent or more of GE

content; labeling for products with more than 0.05 percent of GE content; and the requirement that shipments of bulk commodities be accompanied by documentation certifying that there is no GE content. Sri Lankan importers have raised several concerns about the regulation, including that conformity with a 0.05 percent GE content labeling threshold would be costly and that mandatory labeling could needlessly raise consumer concerns with biotechnology. Additionally, importers fear that bureaucratic procedures in granting approvals - as well as Sri Lanka's technical inability to carry out approvals - may obstruct and limit future imports of GE products. For example, a 2008 U.S. GE corn shipment was cancelled due to excessive bureaucratic delays. This decision has discouraged many Sri Lankan importers from attempting to import unprocessed GE bulk commodities, as it is understood that their import license application will be ignored, delayed or refused.

¶20. During October 2009 discussions under the United States-Sri Lanka Trade and Investment Framework Agreement (TIFA), the United States raised concerns regarding Sri Lanka's mandatory labeling requirement, noting a lack of scientific justification, and adding that the regulation would essentially act as a nontariff barrier. Sri Lanka stated that they would follow CODEX Alimentarius guidelines pertaining to the labeling of GE foods, and noted that CODEX had not yet ruled on this issue. The United States also reminded Sri Lanka of the trade ramifications of their GE policy, including the previously mentioned corn shipment as well as a rejected November 2008 food aid shipment of rice. Sri Lankan regulators were not persuaded to change their position. The USG will continue to raise the issue.

¶21. USDA has sent several local scientists and regulators for training in biotechnology and biosafety at Michigan State University. The most recent regulator to participate in this program is the Director of Biosafety at the Ministry of Environment, who is a senior regulator with respect to agricultural biotechnology. He is also the coordinator for the National Biosafety framework. His view of biotechnology was positively transformed by the training, and he acknowledged several previous personal misconceptions. USDA and the State Department will continue to work with Ministry of Environment officials to affect regulatory change.

¶22. Poultry: Sri Lanka has banned the importation of U.S. chicken meat that is not mechanically deboned. During the October 2009 United States-Sri Lanka Trade and Investment Framework Agreement (TIFA) meeting, Sri Lanka openly admitted that this measure was in place to protect its domestic industry and contended that this was permitted under the use of a WTO safeguard mechanism. The U.S. government responded that if this were the case, that safeguard should be formally raised within the WTO. Additionally, Sri Lanka had imposed avian influenza bans on all poultry and poultry products imported from several U.S. states. As of October 2009, these bans were all removed. Sri Lanka imposed these bans due to the detection of low pathogenicity notifiable avian influenza, an action which is not supported by the World Organization for Animal Health (OIE). Sri Lanka was reluctant to remove the bans and continues to believe that their actions were justified - raising concerns that such action may reoccur.

¶23. Beef: A ban on U.S. beef imports remains in effect due to the detection of bovine spongiform encephalopathy (BSE) in the United States in 2003. This ban is also not supported by the OIE, and Sri Lanka is one of five countries in the world to have taken absolutely no action to lift any part of their BSE-related U.S. beef ban. This issue was raised during the October 2009 TIFA. Sri Lanka defended their position by incorrectly citing the guidelines and recommendations of the OIE's guidelines for meat and poultry.

¶24. Microbiological Testing of Meat Imports: In September 2009, Sri Lanka started 100% testing of all imported meat products for various pathogens. This policy change was not notified to the WTO. Importers have complained that the additional demurrage costs associated with the testing are unnecessary, and that government testing methods are not sound. The U.S. Department of Agriculture additionally argues that the USDA Food Safety Inspection Service

attestation which mandatorily accompanies all meat exports is a sufficient assurance of wholesomeness. During the October 2009 TIFA, Sri Lanka was asked to provide its regulation on microbiological testing, especially as it relates to their testing protocol, targeted pathogens, and acceptable pathogen levels. The U.S. government also emphasized the importance of notifying the WTO SPS committee of this regulation.

¶25. Seed Potatoes: Sri Lanka lifted a ban on imports of seed potato from the United States in March 2007, initially instituted due to fears that the Colorado Potato Beetle (CPB) could have been introduced into Sri Lanka by these imports. However, Sri Lanka now requires a certificate from a plant entomologist stating that the CPB does not exist in the potato tuber to accompany the seed potato imports. The United States has pressed for the removal of this certificate requirement on the grounds that it was not scientifically justified. In July 2008, Sri Lankan officials visited the U.S. potato industry to further review the issue. It is hoped that as a result of this visit, the issue will be resolved and a visual inspection at the time of shipment will be considered sufficient to address any concerns. Although this issue may be addressed, recent 2008 import permits have included overly restrictive virus tolerances and requirements on generations of seed potatoes. There is concern that the generation requirements are not being applied to seed potatoes imported from other markets such as Europe. The CPB area freedom certificate, virus tolerances, and restrictive generation requirements all need to be addressed before the Sri Lankan market can grow into a strong commercial export market for U.S. seed potatoes.

GOVERNMENT PROCUREMENT

¶26. Sri Lanka is not a signatory to the WTO Agreement on Government Procurement and has no plans to join it beyond its current observer status.

¶27. Government procurement of goods and services is primarily undertaken through a public tender process. Some tenders are open only to registered suppliers. Procurement is also undertaken outside the normal competitive tender process. Examples of such

procurement include agreements in 2006 with the government of China to build a coal power plant and for two Chinese companies to build a new bulk cargo port in Hambantota, and an agreement with India to build a coal power plant.

¶28. The government publicly subscribes to principles of international competitive bidding, but charges of corruption and unfair awards are common. In 2006, Sri Lanka published new guidelines, as well as a new procurement manual, to improve the public procurement process. However, in early 2008 the government disbanded the National Procurement Agency, which it had established in 2004, and shifted its functions to a unit in the Ministry of Finance. This move has raised concerns about the government's commitment to improve the transparency of procurements. Despite being discussed during the 2009 TIFA talks, the government of Sri Lanka has yet to respond to the concerns raised.

INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION

¶29. In 2003, Sri Lanka's new intellectual property law - governing copyrights, patents, trademarks, and industrial design - came into force. Under the new law, IPR infringement is a criminal offense and IPR infringement is subject to both criminal and civil jurisdiction. Sri Lanka also passed a new Computer Crimes Act in 2007 strengthening Sri Lanka's IPR regime pertaining to software.

¶30. Notwithstanding the new laws, weak IPR enforcement remains a problem. Piracy levels remain very high for sound recordings and software. According to a study commissioned by the Business Software Alliance, as much as 90 percent of personal computers in Sri Lanka used pirated software in 2008. The study estimates retail revenue losses of $97 million in 2008 due to software piracy. Further, government use of unauthorized software continues to be a problem.

¶31. Redress through the courts for IPR infringement is often a frustrating and time-consuming process. While police can take action against counterfeiting and piracy without complaints by rights holders, they rarely do so. In 2008-2009, the Business Software Alliance successfully worked with government authorities to increase prosecutions for IPR infringement in the software sector. In the apparel sector, right holders have scored some legal successes in combating trademark counterfeiting.

¶32. The Sri Lankan Government's Director of Intellectual Property, along with international experts, continues to have IPR legal and enforcement training for customs, judicial and police officials. The U.S. Embassy, the United States Patent and Trademarks Office, the American Chamber of Commerce of Sri Lanka, and the European Chamber of Commerce are also working with the government of Sri Lanka and the private sector to improve enforcement, provide enforcement training, and enhance public awareness. Sri Lankan Customs has created a computer based Customs Trade Mark recordation system, although it is yet to be launched.

SERVICES

¶33. Insurance: Sri Lanka does not allow cross-border supply of insurance, with the exception of health and travel insurance. In order to provide all other insurance services to resident Sri Lankans, insurance companies must be incorporated in Sri Lanka. Sri Lanka allows 100 percent foreign ownership for locally incorporated insurance firms, but branching is not allowed. Although Sri Lanka's insurance regulatory body has the authority to establish minimum and maximum premiums for motor, fire and employers liability policies, in practice these premiums are not regulated. In early 2008, the Sri Lankan government implemented a new regulation requiring all insurance companies to reinsure 20 percent of their insurance business with a state-run insurance fund.

¶34. Telecommunications: Telecommunications, especially mobile services, is increasingly competitive and may be the most dynamic service industry in Sri Lanka. The government of Sri Lanka maintains a majority share in one of the fixed line carriers, Sri

Lanka Telecom (SLT), which was previously a wholly owned government entity. All other operators are privately owned.

¶35. Telecommunications (continued): Due to SLT's past monopoly status, it continues to own most of the national fixed line telephone infrastructure (including the main switches and the only two international cable landing stations) and continues to dominate the fixed line sector, affecting the competitiveness of other operators in this segment of the market. The government liberalized international telecommunications in 2003 and issued 33 non-facilities based gateway licenses, ending the SLT monopoly over international telephony.

¶36. Broadcasting: The government imposes taxes on foreign movies, programs, and commercials to be shown on television, ranging from Rs 25,000 (approximately $220) for an imported English-language movie to Rs 90,000 (approximately $790) per half hour of a foreign-language program dubbed in the local language Sinhala. Foreign television commercials are taxed at Rs 500,000 (roughly $4,400) per year. Rates for non-English foreign programming are higher. Government approval is required for all foreign films and programs shown on television.

¶37. Professional Services: There is no formal national policy on liberalization of professional services. In practice, many foreign doctors, nurses, engineers, architects, and accountants work in Sri Lanka. Most of them are employed by foreign companies. Unless the government has recognized a foreign national's professional qualifications, such professional cannot sign documents presented to government institutions or regulatory bodies.

¶38. Professional Services (continued): The Immigration Department grants resident visas for foreign professionals whose services are required for projects approved by the government or by companies approved by the Board of Investment (BOI). Non-BOI companies, such as banks, can also employ foreign staff; however, in practice the

Immigration Department has limited the number of resident visas to levels below those desired by companies.

¶39. Legal Services: Any person, including foreigners, can provide legal consultancy services without being licensed to practice law in Sri Lanka. Only Sri Lankan citizens can register in the Supreme Court and practice law (i.e., appear in courts) in Sri Lanka.

INVESTMENT BARRIERS

¶40. While Sri Lanka welcomes foreign investment, there are restrictions in a wide range of sectors. Foreign investment is not permitted in the following areas: nonbank money lending; pawn brokering; retail trade with a capital investment of less than $1 million (with one notable exception: the BOI permits retail and wholesale trading by reputable international brand names and franchises with an initial investment of not less than $150,000); coastal fishing; education of students under 14 years of age for local examinations; and local degree-awarding university education (institutions awarding overseas degrees are permitted).

¶41. Investment in the following sectors is restricted and subject to screening and approval on a case-by-case basis when foreign equity exceeds 40 percent: shipping and travel agencies; freight forwarding; higher education; mass communications; deep sea fishing; timber-based industries using local timber; mining and primary processing of nonrenewable national resources; and growing and primary processing of tea, rubber, coconut, rice, cocoa, sugar, and spices.

¶42. Foreign investment equity restrictions and government regulations also apply to air transportation, coastal shipping, lotteries, large-scale mechanized gem mining, and "sensitive" industries such as military hardware, illegal narcotics, and currency.

¶43. The BOI offers a range of incentives to both local and foreign investors. To qualify for BOI incentives, investors need to meet

minimum investment and minimum export requirements. In general, the treatment given to foreign investors is nondiscriminatory. Even with incentives and BOI facilitation, however, foreign investors can face difficulties operating in Sri Lanka. Problems range from difficulties in clearing equipment and supplies through customs to obtaining land for factories. The BOI encourages investors to locate their factories in BOI-managed industrial processing zones to avoid land allocation problems. Investors locating in industrial zones also get access to slightly better infrastructure facilities such as improved power reliability, telecommunications, and water supply.

¶44. Information contained in this cable will also be provided to requesting offices as a Word document via email. Questions should be directed to EconOff Ken Kero-Mentz at keroka@state.gov.